



## **Multistate Tax Commission Memorandum**

*States Working Together Since 1967 . . . To Preserve Federalism and Tax Fairness*

To: Members of the Executive Committee  
From: Elizabeth Harchenko, Chair, MTC Compliance Project Steering Committee  
Date: July 9, 2004  
Subject: State Tax Compliance Initiative Steering Committee Report and Referral of Compliance Work Group Recommendations and Reports

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The MTC State Tax Compliance Initiative Steering Committee met on May 28 and June 17 to review the progress and work products of our three Work Groups. The Steering Committee has now unanimously approved the following recommendations and we hereby forward these to you for Executive Committee action.

The first four recommendations on sales and use taxes were previously forwarded to the Executive Committee and approved at the April 29 meeting. These work group recommendations, plus a new, fifth recommendation, are included here and in the Sales and Use Tax Work Group report.

The three work group reports are forwarded to you with this memo.

### **Sales and Use Tax Recommendations**

The recommended initiatives are discussed in detail in the work group report, but can be summarized as:

1. Develop a Template for Informational Mass-Mailings to CPA's and Tax Practitioners. The initiative could be assigned back to the Sales & Use Tax Compliance Work Group for implementation.
2. Promote Awareness of the Existing MTC Voluntary Disclosure Program. The Work Group recommended this initiative be forwarded to an appropriate MTC standing committee for implementation.
3. Develop an MTC Proposed Uniform Affiliate Nexus Statute or Regulation. The Work Group recommended this initiative be forwarded to the MTC Uniformity Committee for further development and implementation.
4. Enhance Exchange of Information to Improve Identification of Non-Filing Companies that have Sales and Use Tax Nexus. The Work Group recommended this

initiative be forwarded to an appropriate MTC standing committee for further development and implementation.

5. Review and Reissue Multistate Tax Commission Policy Statement 2002-01, titled Improving State Sales Taxes to Achieve Fairness and Simplicity.

### **Corporate Income Tax Sheltering Recommendations**

1. **Combined Reporting.** States should adopt combined reporting for jointly owned and operated companies. Dividends from affiliates that are not members of the combined group should be treated as apportionable income unless the holding of stock or receipt of the income is clearly unrelated to the business of the owner. This reinforces the MTC Federalism at Risk recommendation on combined reporting and the MTC Uniformity Committee's current project to develop proposed uniform combined reporting statutes and regulations.
2. **Expense Disallowance Statutes.** In lieu of taking the more comprehensive step of combined reporting and perhaps as an intermediate step with consideration of combined reporting as a possible future goal, separate entity states should enact expense disallowance statutes that are broadly worded to address inter-affiliate transactions that involve intangible property and also perhaps inter-affiliate loan transactions. Exceptions for some transactions may be appropriate, but exceptions to these statutes should be objective and narrow in their application as in the expense disallowance statute for intangible property that was enacted by New York State in 2003. This recommendation could be forwarded to an appropriate group, such as a specialized uniformity task force, or returned to the Corporate Income Tax Sheltering Work Group to provide guidelines to the states on expense disallowance statutes.
3. **Overhaul of UDITPA.** It has been almost 50 years since the drafting of UDITPA. Revisions are clearly needed in the area of sales of services and to address intangibles and the financial services sector. An alternate approach is the development of additional special industry rules through the Uniformity Process of the MTC. Rules could be developed for the sales of services; the sales of financial services businesses, such as those with brokerage or insurance activities that do not fit the current financial services rules; and other areas as needed. We recommend the first approach because this is the most direct and thorough, and could be the most effective in influencing state statutes and in taxing corporate income. The MTC could propose a cooperative effort with the National Conference of Commissioners on Uniform State Laws to overhaul UDITPA. The MTC could also solicit support from professional and private sector groups for this effort.
4. **Adopt Throwback Rules.** To limit the occurrence of "nowhere income" states should enact throwback or throwout rules for both tangible goods and services. In addition, states should require that throwback affidavits be submitted and share this information with the states identified in affidavits. Guidelines for throwback rules

should be included in the current MTC effort to develop proposed uniform combined reporting statutes and regulations.

5. **Disclosure of Filing Positions.** States should enact provisions that require disclosure of inconsistent filing positions where states have similar requirements. Failure to disclose inconsistent positions should be penalized and presumptions based on failure to disclose inconsistent filing positions should be enacted to encourage appropriate reporting by taxpayers. This recommendation could be forwarded to an appropriate group, such as a specialized uniformity task force, or returned to the Corporate Income Tax Sheltering Work Group to provide guidelines to the states on disclosure requirements.
6. **Tax Sheltering and Listed Transactions.** States should take advantage of the information sharing on tax shelter activity under the IRS Memorandum of Understanding and the State Memorandum of Agreement. In addition, they should adopt listed transactions legislation that includes, by reference, federal listed transactions, and provides for the definition of state listed transactions. The 2003 California legislation provides a model for the states in this area. This recommendation could be forwarded to an appropriate group, such as a specialized uniformity task force, or returned to the Corporate Income Tax Sheltering Work Group to provide guidelines to the states on listed transactions statutes.
7. **Enforce “doing business” Statutes.** States should clearly articulate and effectively enforce their nexus standards to ensure more complete reporting of income among the states. In applying nexus standards, states should consider thresholds, taking into consideration costs of administration and compliance.
8. **Proactive Role in Federal Legislation.** The states should take a more proactive role with respect to federal legislation, including legislation that affects state jurisdiction for corporate income taxes and federal issues, such as tax sheltering and corporate inversions, that affect both the federal and state income tax base. This should include advocacy of the MTC factor presence nexus standard and elimination of the restrictions of P.L. 86-272.
9. **Enhance Exchange of Information.** Processes should be established to implement, but not be limited to, recommendations 1-8, possibly to include a clearinghouse for sharing information among the states. This information should include current and recent audit activity. Consideration should also be given to including tax shelter activity and other compliance issues.

### **Pass-through Entities Recommendations**

1. Publicize and Encourage States to Adopt the MTC Uniformity Proposal on Reporting Options for Non-resident Members of Pass-through Entities.
2. Work with California, New York and Pennsylvania as lead states in developing a common database or data warehouse on flow of income from pass-through entities to owners.
3. Develop Educational Resources on Pass-Through Entities for the States.
4. Create an Ongoing Liaison Group to Work with the Internal Revenue Service to Coordinate Compliance Efforts on Proper Reporting of Pass-through Entity Income.

Additional work by the Steering Committee and the work groups depend on the direction provided by the Executive Committee for implementation of these recommendations.